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JULIA L. JOHNSON, CHAIRMAN
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.



GENERAL COUNSEL
ROBERT D. VANDIVER
(850) 413-6248

Public Service Commission

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June 3, 1999

BY AIRBORNE EXPRESS

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th, SW - TW-A325
Washington, DC 20554

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Re: CC Docket No. 99-117, ASD File No. 99-22

Dear Ms. Salas:

Enclosed please find the original and 5 copies of the Florida Public Service Commission Comments in the above noted docket. Please date stamp and return one copy in the enclosed self-addressed envelope.

Sincerely,

A handwritten signature in cursive script that reads "Cynthia B. Miller".

Cynthia B. Miller
Senior Attorney

CBM:jmb
cc: Brad Ramsay
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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON DC 20554

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In the Matters of:

Ameritech Corporation Telephone)
Operating Companies' Continuing)
Property Records Audit)

Bell Atlantic (North) Telephone)
Companies' Continuing Property)
Records Audit)

Bell Atlantic (South) Telephone)
Companies' Continuing Property)
Records Audit)

BellSouth Telecommunications')
Continuing Property Records)
Audit)

Pacific Bell and Nevada Bell)
Telephone Companies' Continuing)
Property Records Audit)

Southwestern Bell Telephone)
Company's Continuing Property)
Records Audit)

US West Telephone Companies')
Continuing Property Records)
Audit)

CC Docket No. 99-117

ASD File No. 99-22

COMMENTS OF THE FLORIDA PUBLIC SERVICE COMMISSION

The Florida Public Service Commission (FPSC) appreciates the opportunity to submit comments to the Federal Communications Commission (FCC) concerning its Notice of Inquiry (NOI) regarding the Continuing Property Records (CPR) audits of certain Regional Bell Operating Companies in CC Docket No. 99-117 in ASD 99-22.

In general, the FPSC applauds the FCC's efforts in performing these audits. Although we believe statistical

validity of the sample was compromised, we believe that the audit results indicate a CPR problem exists and possibly a misstatement of rate base and depreciation expense.

The NOI seeks comment concerning certain issues arising out of the audit reports. The FPSC will focus its comments on the issues as they relate to the BellSouth (BST) audit. We have not reviewed the reports of the other companies.

Issue 1: The validity and reasonableness of the statistical sampling methodologies used by the auditors, including: sample design, the two-stage stratified sampling technique, balance and adjustments made to account for high-cost and lower-cost items, the audit procedures, extrapolation techniques, confidence intervals, and the application of Bayesian techniques.

The sampling of the Central Office Equipment (COE) CPR's of BST by the FCC was a massive and difficult undertaking. It is easy to criticize the technique in hindsight; it is not so easy to be in the middle of a sample, and to make judgement calls that may, or may not, be correct after the process is complete. Regardless of the statistical validity of the sample, the FPSC believes the results indicate there are problems in BST's CPRs worthy of corrective action.

BST, in its response to the FCC audit report findings, argued against the statistical method employed by the FCC. The FCC developed a sample to determine the "proportion of items not found" rather than the "dollar value of missing items". A more basic point is that the statistical validity of a sample and thus, the statistical validity of extrapolating to a population, rests on adherence to basic statistical concepts, one of which is

the concept of bias. All sampling units must have an equal chance of being selected. Sample selection is biased whenever any sampling unit has a greater or lesser probability of being selected. When bias is allowed to enter, the sample may no longer represent the population.

The FPSC believes the statistical validity of the sample was compromised, and extrapolation to the population is not advisable because of two concerns. First, some COE locations selected were deemed "impractical to audit", and were subsequently replaced with other COE locations. If it is important for time constraints, budget, or any other reason to not include these locations in the sample, then they should be eliminated from the original population before the sample selection. If not, the sample results should not be extrapolated to the population.

Second, after the original sample was selected, it was noted that North Carolina was not represented. A COE location from North Carolina was then selected to be included in the sample. This introduced bias because all COE locations in other states did not have the same probability of being selected as did the COE in North Carolina. If it was important for each state to be represented in the sample then this should have been included in the original sample design; but the time to do so was before the sample selection was pulled, not after.

Issue 2: The validity and reasonableness of the methodology used by the Bureau's auditors in determining whether to rescore or to modify a finding during a field audit that equipment was "not found."

SOURCE DOCUMENTATION

The basic standard that the companies were required to meet in order to have an item rescored was to provide adequate and convincing evidence that the facts were different than appeared at the time of the auditors' on-site inspection. Additional evidence had to have strong probative (substantiating) value equal to the physical inspection evidence. The FPSC would agree that the source documents that contain cost amounts, signatures, dates, and other information offer the most convincing evidence relative to the installation and removal of equipment. If an original invoice matched the CPR as far as dates of purchase, description of equipment, and costs but the number of units varied, it appears reasonable for the auditors to conclude that rescoring would be appropriate. On the other hand, if the source documentation did not match the descriptions and costs listed in the CPR, it seems reasonable that the auditors would not rescore. Also, the auditors not rescoring based on the companies providing non-source documentation seems valid.

INTERIM RETIREMENTS

Rescoring appears reasonable when the company provided source documentation that there were retirements between the time the CPR listing was printed and the date of the on-site documentation. Documentation included a TEO (telephone equipment

order) which included dates of removal authorization and authorizing signatures. The FPSC agrees with the auditors' conclusion that documentation without authorizing signatures or dates of removal is not considered adequate documentation.

ENGINEERING DRAWINGS

The auditors rescored an item "as found" if the company provided evidence through engineering drawings or manufacturing schematics that a particular item could not be seen because it was embedded in another item. If the evidence provided by the company was not conclusive or if no evidence was provided, the item remained scored as unverified. These classifications by the auditors appear to be reasonable.

ISSUE 3: To the extent the auditors' sampling, rescoring and other methodologies were valid, whether the degree of error in the CPR records determined by the auditors is sufficient to require corrective action.

Regardless of the FPSC's concerns with the audit sampling as discussed in Issue 1, we believe an 18% error rate indicates there is a problem with the CPRs and corrective action should be taken. However, corrective action should be limited to compliance with CPR procedures. Any dollar adjustment should be limited to only those items found in dispute; not extrapolated to the population.

ISSUE 4: What accounting adjustments, if any, should be made to account for "missing" plant.

Based on the audit objectives, only adjustments relating to items the auditors found in dispute should be made. To the extent that the company is unable to provide documentation that

show CPR items were properly capitalized or ever purchased, the associated costs should be written-off to equity. However, if there is equipment listed on the CPR that is no longer in service, and the company provides substantiating documentation that it was purchased and properly capitalized, an inventory adjustment should be made to reflect the retirement.

ISSUE 5: What accounting corrections, if any, should be used to resolve the undetailed investment identified in the audit reports?

According to the audit report, 12.3% of the total COE CPR records referred to undetailed investment or unallocated other costs. No equipment or location descriptions were found in these records making a physical verification impossible. BST was unable to provide cost support for a sample of twenty-five Unallocated Other Costs listings. Based on this, the FCC auditors assumed that BST would not be able to provide cost support for the remaining listings. The total cost of these undetailed items is \$263.9 million, less than 2% of the total COE investment.

Based on the audit objectives, only adjustments relating to items the auditors found in dispute should be made. To the extent that the company is unable to provide documentation that show CPR items were properly capitalized or ever purchased, the associated costs should be written-off to equity.

ISSUE 6: The recommendation of the auditors that the companies should be required to engage independent firms to perform an inventory of their entire central office equipment and provide the results to the Commission, and that the Commission should analyze the results of the inventory and direct the companies to make necessary entries to correct their CPRs and account balances.

An inventory of a company's entire central office equipment is the most ideal and theoretically correct way to verify the accuracy of CPRs. BST, in its response to the FCC audit report findings, also agrees that a complete inventory of assets is an important and necessary control to ensure that its records are continually improving and remain accurate.

Additionally, BST agrees to engage an independent audit firm to conduct a statistically valid sample based inventory and reconciliation of its entire COE. BST also agrees to report the findings from the audit and inventory reconciliation to the FCC. The FPSC finds this a satisfactory proposal to achieve the goal of correct CPRs. However, we suggest that the audit be performed under the auspices of the FCC with similar procedural requirements as the Biennial Audits under Section 272 of the Telecommunications Act of 1996 (Act). In this respect, the results of the audit should be submitted to the FCC and also to the state commissions. Further, the FCC and the state commissions should have access to the CPRs, working papers, and supporting materials of the auditor.

BST proposes to conduct this additional audit in accord with its current COE inventory cycle schedule of one-eighth of

the Hard-Wired Equipment each year. As a result, the audit and full inventory would be completed in eight years. The FPSC agrees with BST that the cost of a complete inventory will increase as the time period is shortened. However, eight years is a long time for this subject to remain unresolved. The FPSC suggests that the FCC consider a period of time for the independent audit and inventory in accord with the associated cost.

ISSUE 7: The recommendation of the auditors that, in order to improve the likelihood that the CPRs will be maintained correctly in the future, the companies should be required to engage independent auditors to review their practices, procedures, and controls for maintaining CPRs and to make recommendations for improving these systems so that the CPR plant balances can be maintained in compliance with the Commission's rules (parties should address the specific recommendations concerning the practices, procedures, and controls addressed by the auditors in the recommendations sections of the audit reports)

In response to the FCC audit report findings, BST agrees to an audit by an independent auditor of its practices, procedures, and controls for maintaining its CPRs. This will include review of BST's procedures for conducting the inventories and reconciliations of its COE that it is currently performing. The FPSC suggests that this audit be performed under the management of the FCC and monitored by state commission staff in a similar fashion as the Biennial Audits under Section 272 of the Act.

Issue 8: What ratepayer impact, if any, the alleged discrepancies in the CPR may have had, e.g., through the derivation of the Commission's price cap rates, including reinitialization of price caps, sharing, lower formula adjustments, exogenous cost calculations, and changes to or setting of the productivity factors, joint cost allocations, separations, access charges, and ultimately ratemaking.

The FPSC believes that if the plant balances were overstated at the time of the setting of Price Caps, then prices may have initially been set incorrectly. The overstatement of investment in COE could affect separations between interstate and intrastate and also could affect the allocation of costs between regulated and nonregulated.

Issue 9: Whether the property record discrepancies have any impact on (1) calculations under the Telecommunications Act of 1996 relating to (a) universal service support and (b) pricing of unbundled network elements, and (2) the merits of "takings" claims and "stranded costs" recovery.

(1)(a) The FPSC believes that the CPR discrepancies could have an impact on current levels of universal support since the existing methodology calculates support based on historical financial information. On a forward-looking basis, interstate universal service support for nonrural LECs may also be affected, to the extent that the proxy model employed utilizes historical relationships to determine forward-looking plant specific expense and other expense categories. It is unclear at this point when Florida will implement a state USF; however, when one is established, use of erroneous embedded data similarly may result in misstatements of funding requirements, if estimates of expense

levels attributable to universal service are based on faulty historical cost relationships. In either event, the reliance on historical costs that are misstated could mean the calculations used to establish a Florida USF may be inaccurate.

Issue 10: Any other issue or issues pertinent to the audit reports or the company responses. These issues may include but are not limited to: (1) the benefits of compliance with our rules, as well as the consistency of these rules with other statutory and regulatory policies; (2) the reasonableness of the auditors' interpretations of the CPR requirements; (3) the history and consistency of the FCC's procedure and enforcement of these requirements; and, (4) what other federal and state agencies do and what GAAP requires to ensure the accuracy of books and records.

It is difficult to quantify the impact to Florida ratepayers since the CPR audits were performed on a total nine state basis for BST. Florida does require that BST, at least up through 1997, follow the FCC Part 32 accounting requirements. The FPSC believes that it would need to perform an audit to determine the impact to Florida ratepayers of any overstatement of intrastate rate base or intrastate expenses.

Conclusion: In conclusion, the FPSC believes that regardless of the fact that bias was introduced into the sampling process, the FCC's audit indicates there is a potentially significant problem with BST's CPRs and a possible misstatement of rate base. Based on the audit objectives, corrective action, at this time, should be limited to compliance with CPR procedures. The dollar adjustment should be subject to further audit.

Any dollar adjustment should address only those items found in dispute, not extrapolated to the population. To the extent that the Company is unable to provide documentation that shows CPR items were properly capitalized or purchased, the associated costs should be written-off against equity. However, if there is equipment listed on the CPR that is no longer in service, and the company provides substantiating documentation that it was purchased and properly capitalized, an inventory adjustment should be made to reflect the retirement.

The FPSC believes that if the plant balances were overstated at the time of the setting of interstate Price Caps then prices may have initially been set incorrectly. Additionally, we believe that CPR discrepancies could have an impact on levels of universal service support to the extent that the methodology used to calculate the support uses historical financial information. The difficulty lies in trying to quantify the impact to Florida ratepayers as the CPR audits were done on a total nine-state basis for BST. As a result, the FPSC believes there is a need to perform its own audit to determine the ratepayer impact of any overstatement of intrastate rate base or intrastate expenses.

Finally, BST's proposal to engage an independent audit firm to conduct a statistically valid sample based inventory and reconciliation of its entire COE and to continue its current inventory and reconciliation process of COE represent a satisfactory proposal to achieve the goal of correct and reliable

CPRs. This will include an audit of BST's practices, procedures, and controls for maintaining its CPRs. The FPSC believes that these audits should be performed under the auspices of the FCC with similar procedural requirements as the Biennial Audits under Section 272 of the Act. Furthermore, the FPSC suggests the FCC consider a shorter period of time than eight years as suggested by BST for these additional audits. The time period should be decided in consideration of the cost.

Respectfully submitted,


CYNTHIA B. MILLER
Senior Attorney

Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850
(850) 413-6082

Dated: June 3, 1999